No. 91-615

In the Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation, PETITIONER

v.

DIRECTOR, DIVISION OF TAXATION, RESPONDENT

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF PETITIONER ON REARGUMENT

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INTRODUCTION

The order restoring this case to the calendar for reargument strongly suggests that this Court is not prepared to accept the New Jersey Supreme Court's semantic end-run around *ASARCO* and *Woolworth*. As New Jersey essentially conceded at oral argument, it cannot prevail in this case on the basis of interpretation and application of existing precedent. Hence New Jersey asks the Court to overrule *ASARCO* and *Woolworth* and to discard the unitary business principle on which they rest. In response to this request, the Court has posed the following three questions:

1. Should the Court overrule *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)?
2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

SUMMARY OF ARGUMENT

There are essentially two ways in which the Court might "overrule" *ASARCO* and *Woolworth*. First, it might selectively abandon the doctrine that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), and hold that, with respect to intangibles, all of a taxpayer's income is apportionable regardless of whether any operational connection exists between the income and the taxpayer's business activities in the taxing state. Second, it might abandon the unitary business principle altogether and hold that all of a taxpayer's income from tangible as well as intangible assets is apportionable. Because each of these alternatives would jettison the sound constitutional postulates on which *ASARCO* and *Woolworth* squarely rest and would introduce more unfairness, more uncertainty, and more complexity than is even arguably encountered under the existing constitutional regime, *ASARCO* and *Woolworth* should be reaffirmed.

1. *The sound constitutional principles underlying* ASARCO *and* Woolworth. No rule is more firmly embedded in this Court's Commerce and Due Process Clause jurisprudence than the bedrock principle that a state may not tax activities with which it lacks a concrete connection. The unitary business principle reflects this rule. On the one hand, as a limited exception to the general proposition that a state may not look beyond its borders in exercising its tax power, the unitary business principle permits states to consider a taxpayer's out-of-state activities in determining its state tax liability when the taxpayer's out-of-state activities are organically related to its in-state activities. On the other hand, the unitary

business principle prevents states from considering a taxpayer's out-of-state activities when they are not organically related to the taxpayer's in-state activities.

For more than a century, the Court has faithfully adhered to the unitary business principle in determining the propriety of state tax apportionments with respect to both direct operating income and income from intangibles. *ASARCO* and *Woolworth* are sewn from the same fabric as these earlier decisions. Thus long-standing and well-reasoned decisions of this Court support the precise holding of *ASARCO* and *Woolworth* with respect to income from intangibles: A state may not include in a nondomiciliary corporation's apportionable tax base investment income unrelated to the corporation's business operations in the state simply because the investment activity served a general corporate purpose.

2. *The mischievous consequences of overruling* ASARCO *and* Woolworth. If the Court were to abandon the unitary business principle selectively, and hold all intangible income apportionable to every state in which the taxpayer has any taxable presence, it would create a wholly unsatisfactory regime for state taxation of multistate corporate income. Form rather than substance would govern the apportionability of income, with one rule applying to the apportionment of income from intangibles and another applying to the apportionment of income from tangibles, even though the taxpayer's relationship to the income in the two cases may be economically identical. Moreover, state tax apportionments would routinely violate the "external consistency" principle as intangible income would be apportioned by factors that did not reflect the way in which the income was generated. Courts would inevitably become more embroiled in questions bearing on the proper apportionment of intangibles, and state tax administration would become much more complex. Perhaps most significantly, the established, workable, and substantially uniform system of state laws governing taxa-

tion of investment income, which apportions income from intangibles employed in business operations and allocates other investment income, would be left in shambles.

If, on the other hand, the Court were to abandon the unitary business principle in its entirety, as New Jersey urged at oral argument, and hold that all of a taxpayer's income was apportionable regardless of its connection to the taxpayer's activities in the taxing state, it would shed the formalities of a rule that distinguished between intangible and direct operating income, but the results would be equally indefensible. Not only would such a rule create many of the problems identified above, the ensuing constitutional regime would also sanction gross misattribution of income. Some states would be permitted to tax out-of-state income, while others would be forbidden from taxing in-state income. To avoid the bizarrely unfair results that such a regime would spawn, courts would inevitably become more entangled with the details of controversies over the fairness of state tax apportionments.

3. *Stare decisis.* Considerations of *stare decisis* strongly favor the reaffirmation of *ASARCO* and *Woolworth.* The rules at issue here involve property interests, as to which the value of stability and the significance of reliance interests are most compelling. Indeed, the overruling of *ASARCO* and *Woolworth* would render unconstitutional the vast majority of the states' taxing schemes, which have been constructed around this Court's firmly established understanding of the prior law. Moreover, none of the customary indicia of the need for overruling is present. *ASARCO* and *Woolworth* are fully in harmony with the Court's Commerce and Due Process Clause jurisprudence and their soundness has not been questioned in subsequent cases.

4. *Retroactivity.* If *ASARCO* and *Woolworth* are overruled, the Court's decision should not apply retroactively.

The Court should apply the *Chevron Oil* test in determining whether new principles of law control the case before it. Application of that test dictates prospective application of a decision overruling *ASARCO* and *Woolworth* because such a decision would establish a new principle of law and would disrupt reasonable expectations concerning a vast range of transactions, confounding reliance interests of both taxpayers and states on the preexisting rule of law.

I. *ASARCO* AND *WOOLWORTH* SHOULD NOT BE OVERRULED BECAUSE THEY REFLECT SOUND AND DEEPLY ROOTED CONSTITUTIONAL RESTRAINTS ON STATE INCOME TAXATION OF MULTISTATE CORPORATIONS

Our understanding of the Court's reference to "overruling" *ASARCO* and *Woolworth* envisions a radical restructuring of the law governing state taxation of multistate corporations.[1] At a minimum, it suggests that the Court is considering selectively abandoning the unitary

[1] In our view, therefore, "overruling" would not embrace any clarification the Court may see fit to make in language in *ASARCO* and *Woolworth* that could be read as precluding nondomiciliary states from apportioning intangible income in *all* cases in which the "business activities of the . . . payor have nothing to do with the activities of the recipient in the taxing State." *ASARCO*, 458 U.S. at 327, and *Woolworth*, 458 U.S. at 371 (both quoting *Mobil*, 445 U.S. at 442). Allied-Signal has never taken issue with the proposition that income from working capital or from assets serving an operational function under the *Corn Products* doctrine is properly apportionable by a nondomiciliary state in which a taxpayer does business without regard to the relationship between the payor and the payee. Allied-Signal Br. 40; Allied-Signal Rep. Br. 3. Hence we would not consider the Court's explicit acknowledgement of this proposition, which was never at issue in *ASARCO* and *Woolworth*, *ASARCO*, 458 U.S. at 337 & 337-38 n.5 (O'Connor, J., dissenting); Tr. of *Woolworth* Oral Argument at 16-17, and which was tacitly recognized in *Container Corporaiton of America v. Franchise Tax Bd.*, 463 U.S. 159, 180 n.19 (1983), as "overruling" *ASARCO* and *Woolworth*.

business principle by permitting any state in which a corporation does any business to tax an apportioned share of its intangible income regardless of the existence of an operational connection between such income and the corporation's business activity in the taxing state. More fundamentally, it suggests that the Court may be considering complete abandonment of the unitary business principle with respect to *all* income earned by multistate corporations, whether from tangible or intangible assets. As we demonstrate below, however, there is no theoretical or practical justification—with respect either to intangible income or to income generally—for the wholesale abandonment of the constitutional principles that have long guided state taxation of the income of multistate corporations.

A. The Unitary Business Principle, On Which *ASARCO* and *Woolworth* Squarely Rest, Embodies The Sound Constitutional Postulate That States May Not Tax Activities With Which They Have No Concrete Connection

The essential holding of *ASARCO* and *Woolworth*—that a state may not include in a nondomiciliary corporation's apportionable tax base investment income unrelated to the corporation's business operations in the state simply because the investment activity served a general corporate purpose—rests on the bedrock constitutional principle that there must be "some definite link, some minimum connection" between a state and the activity it seeks to tax. *Miller Bros v. Maryland*, 347 U.S. 340, 344-45 (1954). The underlying rationale for this virtually axiomatic proposition is that the exercise of a state's tax power over a taxpayer's activities is justified by the "protection, opportunities and benefits" the state confers upon such activities. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). If the state lacks a "definite link" or "minimum connection" with the activities in question, it has not "given anything for which it can ask return." *Id.*

When a state seeks to include income from a taxpayer's out-of-state activities in a taxpayer's apportionable tax base, the Court has consistently measured that "definite link" or "minimum connection" by reference to the unitary business principle. Under that principle, if a taxpayer is carrying on a single "unitary" business within and without the state, the state has the requisite connection to the out-of-state activities of the business to justify the inclusion in the taxpayer's apportionable tax base of all income generated by the combined effect of the out-of-state and in-state activities. By the same token, however, if the taxpayer's income-producing activities carried on within the state are not unitary with its income-producing activities carried on elsewhere, the state is constitutionally constrained from including the income arising from those out-of-state activities in the taxpayer's apportionable tax base when the taxpayer is not domiciled in the taxing state.

Although it was not until 1980 that the Court declared that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle," *Mobil*, 445 U.S. at 439, this principle, the Court was quick to point out, was not "new." *ASARCO*, 458 U.S. at 320 n.14. Indeed, "[i]t has been a familiar concept in our tax cases for over 60 years." *Id.* (citing cases).

The unitary business principle derives from the "unit rule" developed in the late 19th century for apportioning property values of railroad, telegraph, and express companies to state or local taxing jurisdictions. Isaacs, *The Unit Rule*, 35 Yale L.J. 838 (1926). To ascertain the value of a company's property that was properly attributable to the taxing jurisdiction, states and localities would determine the value of the entire operating system and then assign to the state or locality a proportion of the system value based on the ratio of the amount of some identifiable factor to the amount of such factor in the entire system. See, *e.g.*, *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18, 26 (1891) (track mileage);

Western Union Telegraph Co. v. Taggart, 163 U.S. 1, 18 (1896) (telegraph line mileage). When taxpayers complained that taxing jurisdictions were exceeding their power by taking account of extraterritorial values for purposes of determining the proper value of the taxpayer's property attributable to the taxing state or locality, the Court responded:

> But . . . a railroad must be regarded for many, indeed for most purposes, as a unit. The track of the road is but one track from one end of it to the other, and except in its use as one track, is of little value. In this track as a whole each county through which it passes has an interest much more important than it has in the limited part of it lying within its boundary. . . . It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road, and apportion the value within the county by its relative length to the whole.

State Railroad Tax Cases, 92 U.S. 575, 608 (1875). The Court subsequently expanded the concept of the "unit rule" beyond cases in which there was a contiguous physical unity connecting the taxpayer's property in various states to cases in which there was operational—but no physical—unity. *Adams Express Co. v. Ohio*, 165 U.S. 194 (1897); *American Express Co. v. Indiana*, 165 U.S. 255 (1897); *Adams Express Co. v. Kentucky*, 166 U.S. 171 (1898).

When the Court began to confront constitutional challenges to apportioned net income taxes in the 1920's, it applied the same "unit rule" principles it had developed in adjudicating the constitutionality of apportioned property taxes. P. Hartman, *Federal Limitations on State and Local Taxation* 26 (1981); Huston, *Allocation of Corporate Net Income for Purposes of Taxation*, 26 Ill. L. Rev. 725, 728-32 (1932). The Court recognized that when corporate income was "largely earned by a series

of transactions beginning with manufacture in [one state] and ending with sales in other States," *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120 (1920), apportionment was a reasonable method for assigning the taxpayer's income to each of the various states in light of the "impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Id.* at 121; see also *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 132-33 (1931).

In delineating the contours of a unitary business, however, the Court never lost sight of the fact that the underlying unity was not comprised of everything that happened to be owned by the taxpayer:

> We repeat that while the unity which exists may not be a physical unity, *it is something more than a mere unity of ownership.* It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business.

Adams Express, 165 U.S. at 222 (emphasis supplied). In *Butler Brothers v. McColgan*, 315 U.S. 501 (1942), the Court reiterated that it was "unity of use and management of a business" that justified the state's inclusion of income generated by out-of-state activities in the apportionable tax base. *Id.* at 508 (citing *Adams Express*). In *Mobil*, the Court described a unitary business as one characterized by "functional integration, centralization of management, and economies of scale." *Mobil*, 445 U.S. at 438. And in *Container*, the Court emphasized the fundamental notion that to be unitary "the out-of-state activities of the purported 'unitary business' must be related in some concrete way to the in-state activities," and that there must be "some sharing or exchange of value not capable of precise identification—*beyond the mere flow of funds arising out of a passive investment or*

a distinct business operation." *Id.* at 166 (emphasis supplied).

The core holdings of *ASARCO* and *Woolworth*—that a state may not include in a taxpayer's apportionable tax base investment income not organically connected to its business activities in the state—flow inexorably from the Court's unitary business precedents. Such unrelated investment income simply does not derive from the business "unit" engaged in income-producing activities in the state. Consequently, there is no "unity of use . . . resulting from the very nature of the business" (*Adams Express*, 165 U.S. at 222) and no connection in any "concrete way" (*Container*, 463 U.S. at 166) between the taxpayer's out-of-state activities and the taxing state. There is merely income that contributes to the "pecuniary profit of the owner" (*id.*), a fact that, by itself, fails to link the income to the taxing state. Indeed, to have accepted the states' contentions in *ASARCO* and *Woolworth* (and New Jersey's contention here) that income is apportionable just because it "adds to the riches of the corporation" (*Wallace v. Hines*, 253 U.S. 66, 70 (1920)) would have ripped those cases from the fabric of the law that the Court has carefully woven over the past century. More significantly, it would have deprived the unitary business concept of its basic constitutional function, namely, to confine the exercise of a state's tax power to those activities to which it has accorded some palpable benefit.

B. The Specific Rule Governing *ASARCO* And *Woolworth*—That Investments Not Organically Related To The Taxpayer's Business In The Taxing State Must Be Excluded From The Apportionable Tax Base—Comports With The Well-Reasoned Decisions Of This Court And The Disinterested Views Of Academic Commentators

Beyond the fact that *ASARCO* and *Woolworth* faithfully reflect the general constitutional principles that lie at the heart of this Court's state tax jurisprudence, the

well-reasoned decisions of this Court and the views of disinterested academic observers demonstrate the essential wisdom of the specific principle of *ASARCO* and *Woolworth*, namely, that intangible invetments unrelated to a taxpayer's business operations may not be considered part of a unitary business.

Consequently, if this Court were to abandon this principle, it is not only *ASARCO* and *Woolworth* that the Court would have to overrule. In *Fargo v. Hart*, 193 U.S. 490 (1904), Indiana purported to apply the unitary business principles laid down in the earlier express company cases[2] to value the property of an interstate express business. Indiana treated the whole business as a unit and assessed the property on a proportion of the total value of its property determined by the ratio of the mileage in Indiana to the total mileage of the company.

A problem arose because the property that Indiana included in the taxable "unit" consisted not only of the real and personal property that the company used in its express business within and without Indiana, but also $15.5 million of bonds that it held in New York. Testimony showed that the bonds were not "necessary" for the express business carried on in Indiana and "in fact [were] not used" for such business. *Fargo*, 193 U.S. at 500. The Court held that the bonds could not constitutionally be included in the company's apportionable tax base. "The express business added nothing to the value of the bonds in New York." *Id.* "Conversely, the utmost extent to which those bonds entered into the value of property in Indiana was in so far as they helped to make the public believe that the express company could be trusted and therefore increased its good will." *Id.* This "attenuated relation[]" (*id.*) did not provide the essential "organic connection" (*id.* at 499) between the taxpayer's express business in Indiana and its out-of-state investment.

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[2] See *Adams Express Co. v. Ohio*; *American Express*; *Adams Express Co. v. Kentucky.*

The Court reaffirmed this holding in *Wallace v. Hines*, 253 U.S. 66 (1920). North Dakota sought to include the value of interstate railroads' stocks and bonds in their North Dakota apportionable property tax base. The Court unequivocally rejected the effort, citing the most basic of constitutional concerns. It observed that "[t]he *only* reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they would otherwise possess." *Id.* at 69 (emphasis supplied). The purpose is not, the Court continued "to expose the heel of the system to a mortal dart—not, in other words to open to taxation what is not within the State." *Id.* Consequently, the bonds secured by mortgage of lands in other States and other property that "adds to the riches of the corporation but does not affect the North Dakota part of the road" (*id.* at 70) could not be included in the apportionable tax base. *See also Oklahoma v. Wells, Fargo & Co.*, 223 U.S. 298, 300 (1912) (receipts from out-of-state investment in bonds could not be included in nondomiciliary express company's apportionable tax base on authority of *Fargo v. Hart*).

In *ASARCO* and *Woolworth*, the Court properly recognized the controlling force of its earlier decisions precluding states from taxing investments unrelated to nondomiciliary taxpayer's in-state business activities. *ASARCO*, 458 U.S. at 320 n.14, 328 (citing *Fargo* and *Wallace*); *Woolworth*, 458 U.S. at 354 (citing *Wallace*). The underlying rationale of this consistent line of decisions is as sound now as it was then.

Indeed, disinterested observers have long recognized that the *raison d'être* of the unitary business principle precludes the apportionability of investments not organically related to the taxpayer's in-state operations. As

Professor Bonbright noted in his classic treatise on valuation:

> The balance sheet of almost every modern corporation covers certain assets which are of little or no service to the going concern. These assets may include cash in excess of working-capital requirements; *securities held for investment rather than for control*; real estate no longer needed in the business and awaiting sale in a favorable market . . . .
>
> When assets of an interstate corporation are thus completely divorced from the interstate business, there is no good reason why they should be subject to assessment under the unit rule.

2 J. Bonbright, *Valuation of Property* 660 (1937) (emphasis supplied).

Likewise, two distinguished students of the unitary business principle,[3] have provided a pertinent illustration of why a taxpayer's investment income should not be included in its apportionable tax base. They posit the case of an interstate railroad company, which has accumulated large reserves invested in stocks and bonds of other companies, from which it derives substantial income in the form of dividends and interest. The investment activities are carried on in the headquarters office where the railroad operations are managed and controlled. Some

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[3] The writings of these men, Frank M. Keesling and John S. Warren, on the unitary business principle, have been cited frequently by the Court. *See* G. Altman & F. Keesling, *Allocation of Income in State Taxation* (2d ed. 1950) (cited in *Mobil*, 445 U.S. at 439 n.14); G. Altman & F. Keesling, *Allocation of Income in State Taxation* (1946) (cited in *Woolworth*, 458 U.S. at 371 n.25); Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42 (1960) (cited in *Mobil*, 445 U.S. at 439 n.14, 445 U.S. at 453 n.5, 458-59 n.12 (Stevens, J., dissenting); Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act, Part I*, 15 U.C.L.A. L. Rev. 156 (1967) (cited in *ASARCO*, 458 U.S. at 326 n.22); Keesling & Warren, *California's Uniform Division of Income Tax Purposes Act, Part II*, 15 U.C.L.A. L. Rev. 655 (1968).

individuals devote their entire time to the investment activities, whereas others, including a number of officers, devote part of their time to both the investment activities and the railroad operations.

> Although both activities are commonly owned and managed, and there is some common use of personnel and facilities, and although some practical difficulties may be experienced in segregating the expenses of the investment activities, clearly it would be wrong to consider that the company is engaged in only one business and that the entire income of the company should be apportioned within and without the state by means of a formula. Notwithstanding the common elements, there are two distinct series of income-producing activities. This conclusion follows from the fact that the income from dividends and interest can be identified as being derived from the stocks and bonds and the activities related thereto, and not in any way attributable to the general railroad operations carried on within and without the state.

Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42, 52-53 (1960) (citation omitted), see also 1 J. Hellerstein, *State Taxation* ¶ 9.12[2][b] at 554 (1983).

In short, unless this Court is prepared to abandon a century of precedent reflecting the sound constitutional principle that states may not tax activities to which they provide no benefit, *ASARCO* and *Woolworth* must be reaffirmed.

C. The Existing Regime Of State Taxation Of Investment Income Should Not Be Disturbed Because It Provides A Settled, Workable, And Substantially Uniform Solution To Potentially Troublesome Division-Of-Income Problems

The existing regime of state taxation of investment income has been shaped in large part by this Court's unitary business decisions. Most states have explicitly recognized

the distinction between apportionable and nonapportionable (or allocable) income, by virtue of their adoption of either the Uniform Division of Income for Tax Purposes Act (UDITPA), 7A Uniform Laws Annotated 331 (1985), or similar statutory schemes. 1 Multistate Corporate Income Tax Guide (CCH) ¶¶ 145, 167 (1992). Indeed, UDITPA's definition of apportionable "business income" is no different in substance from this Court's definition of income arising from a unitary business, to wit:

> income arising from transactions and activity in the regular course of the taxpayer's trade or business and includ[ing] income from tangible and intangible property, if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

UDITPA § 1(a). "Nonbusiness income," which is allocable to particular states, is defined as "all income other than business income." UDITPA § 1(e).

In drawing the line between apportionable and allocable investment income, the states generally employ the same criteria that this Court has embraced in distinguishing between apportionable "unitary" income and nonapportionable "nonunitary" income. Thus the regulations of the Multistate Tax Commission (MTC)[4] implementing UDITPA, which have been adopted by about one-third of the states with corporate income taxes, 1 Multistate Corporate Income Tax Guide (CCH) ¶ 145 (1992), provides that interest and dividends are apportionable or allocable depending on their relationship to the taxpayer's underlying business operations. For example, interest from working capital is apportionable "business" income whereas interest earned on funds de-

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[4] The Multistate Tax Commission is the administrative agency of the Multistate Tax Compact, which has adopted UDITPA. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978); *ASARCO*, 458 U.S. at 310 n.3.

rived from the sale of a subsidiary's stock, pending a management decision as to how the funds are to be utilized, is allocable "nonbusiness" income. MTC Reg.IV.1 (c)(3) (examples v, vi), reprinted in 2 Multistate Corporate Income Tax Guide (CCH) ¶ 8162 (1991). Similarly, a construction contractor's dividends from securities held to maintain adequate bonding capacity are apportionable "business" income whereas a manufacturer's dividends from a stock portfolio unrelated to its manufacturing business are allocable "nonbusiness" income. MTC Reg.IV.1(c)(4) (examples iv, vi), reprinted in 2 Multistate Corporate Income Tax Guide (CCH) ¶ 8164 (1991).[5]

The vast majority of states explicitly recognize the distinction between apportionable and allocable investment income; in these states, allocable interest, dividends, and capital gains are assigned—almost without exception—to the taxpayer's commercial domicile. See the Appendix to this brief. This reflects the states' recognition that when investments are not used in the taxpayer's business operations so that there is no warrant for apportioning the income they generate, such income is properly attributable to the seat of the corporation's government. As this Court has observed, "[t]he economic advantages realized through the protection, at the place of domicil, of the ownership of rights in intangibles . . . support the taxation of intangibles at the place of domicil." *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234, 241 (1937).

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[5] Even in states in which the line between apportionable and allocable income has not explicitly been drawn in the statute or regulations, courts have drawn lines that conform to the prevailing pattern. *See, e.g., American Home Products Corp. v. Limbach*, 49 Ohio St. 3d 158, 551 N.E.2d 201, *cert. denied*, 111 S. Ct. 63 (1990) (income from investments used as working capital apportionable; income from investments in excess of working capital nonapportionable); *NCR Corp. v. Comptroller*, 313 Md. 118, 544 A.2d 764 (1988) (income from investments timed to meet taxpayer's operating needs apportionable); see also Allied-Signal Br. 28 n.12.

Furthermore, the state of commercial domicile is typically where the taxpayer's activities in managing its investments occur.

The prevailing pattern of state taxation of investment income generally assures that there will be neither undertaxation nor overtaxation of such income. If the investment is used in the taxpayer's business, the income therefrom will be apportioned among the states in which the taxpayer conducts its business. On the other hand, if the investment is not used in the taxpayer's business, the income therefrom will be allocated to the taxpayer's commercial domicile, which is the state with the most significant connection to the taxpayer and, ordinarily, to its activities associated with the earning of such income.

Despite the existence of a workable, equitable, and substantially uniform framework for state taxation of investment income—a framework deeply rooted in the salutary constitutional principles that the Court has articulated over the years, *see* 1 J. Hellerstein, *State Taxation* ¶ 9.12[2][b] at 555 (1983), some Justices have nevertheless questioned both the logic and fairness of the existing regime. Justice O'Connor's dissenting opinion in *ASARCO* suggested that there is no principled distinction between working capital, the income from which is admittedly apportionable, and other "investments . . . triggered by [a corporation's] need to obtain a return on idle financial resources accumulated for the future operation of its own primary business." *ASARCO*, 458 U.S. at 337 (O'Connor, J., dissenting). In her judgment "[a]ny return ASARCO earned on such investments . . . would be functionally related to the conduct of its . . . business and, therefore taxable . . . on an apportioned basis as unitary business income." *Id.* at 338-39.

With all due respect, we believe that this analysis suffers from two weaknesses.[6] First, the distinction

[6] Allied-Signal need take no issue, however, with much of Justice O'Connor's dissenting opinion in *ASARCO*. For example, Justice

between working capital—capital currently used in business operations—and idle financial resources accumulated for the future operation of a business is well recognized and used for a variety of purposes.[7] The distinction broadly reflects the line between investments that are integrally related to a taxpayer's business operations and those that have only an attenuated relationship to such operations. This is the very line that this Court has properly drawn between apportionable and nonapportionable income. "Capital transactions," this Court has declared, "can serve either an investment function or an operational function." *Container*, 463 U.S. at 180 n.19. That distinction, which the Court had no trouble delineating in *Container*, marks the appropriate divide between assets that have some "organic connection" (*Fargo*, 193 U.S. at 499) to the taxpayer's business and therefore give rise to apportionable income, and those assets that merely "ad[d] to the riches of the corporation" (*Wallace*,

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O'Connor's opinion took the position that ASARCO's investment income, even if assumed to be passive, was nevertheless apportionable because the subsidiary companies were in the same industry as ASARCO. *ASARCO*, 458 U.S. at 335, 336. Even if this position had been adopted by the Court, it would not affect the result here because there is no suggestion that, in investing in ASARCO, Bendix ever relied on "the resources of information and expertise developed in its own . . . business." *Id.* at 337.

Justice O'Connor's opinion also took the position that the Court improperly characterized ASARCO's investments as passive, and that the investments were in fact operationally connected to ASARCO's non-ferrous metals business. *Id.* at 340-44. In this case, by contrast, it was stipulated that "Bendix and ASARCO were unrelated enterprises each of whose activities had nothing to do with the other." Stip. ¶ 62 (J.A. 169).

[7] *See, e.g., Government of Guam v. Federal Maritime Comm'n*, 365 F.2d 515 (D.C. Cir. 1966), *cert. denied sub nom. Pacific Far East Line, Inc. v. Guam*, 385 U.S. 1002 (1967); *Smoot Sand & Gravel Corp. v. Commissioner of Internal Revenue*, 241 F.2d 197, 207 (4th Cir.), *cert. denied*, 354 U.S. 922 (1957); *American Home Products*, 49 Ohio St. 3d at 161, 551 N.E.2d at 205.

253 U.S. at 70) and therefore give rise to income that is properly attributable to the taxpayer's commercial domicile, where the assets are typically managed.

Second, there is no warrant for the assumption underlying the *ASARCO* dissent that the "idle financial resources" in question constitute "[t]he interim investment of retained earnings prior to their commitment to a major corporate project." 458 U.S. at 338. The source of the funds could as easily have come from borrowing as from the company's own business operations; indeed, most of Bendix's funds for its acquisition of ASARCO were borrowed. (Stip. ¶ 52 (J.A. 167)).[8] Moreover, such "idle financial resources" may well be used for purposes wholly unrelated to the taxpayer's operations in the taxing state; they could be distributed as dividends to shareholders or employed in unrelated business operations in other states. The mere possibility that such funds might be used in the business in the future does not justify treating them as being used in the business now.

Justice O'Connor's *ASARCO* dissent also questions the fairness of assigning all of a taxpayer's investment income to its commercial domicile. The dissent reasoned that a domiliciary state's power to tax investment income depends on whether "it confers benefits on or affords protection to the investment activity" and that "[m]ere assertion of the arbitrary legal fiction that intangible prop-

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[8] The fact that Bendix deducted its interest expenses associated with the borrowing from its New Jersey income does not make the investment "unitary," as the dissent in *ASARCO* seems to suggest. *ASARCO*, 458 U.S. at 339. Bendix was simply following the law as written by the New Jersey legislature. New Jersey plainly could have denied Bendix the right to deduct expenses connected with income not taxable by New Jersey. Indeed, many states have provisions that so provide. *See, e.g.*, Cal. Rev. & Tax Code § 24344 (West 1992); Idaho Code § 63-3022(a)(1) (Supp. 1991); Mont. Code Ann. § 15-31-114(4) (1991). Even New Jersey has a provision denying interest expense deductions in circumstances not applicable here. N.J. Stat. Ann. § 54-10E-4(1)(2)(e) (1986).

erty is located at its owner's domicile" does not satisfy the benefits-or-protection standard. *Id.* at 346-47. The dissent further suggested that the functional basis on which the commercial domicile rule was supposedly based —that the intangibles "had become 'integral parts of some local business'" where the taxpayer "maintained 'the actual seat of its corporate government'" (*id.* at 347)—actually supported apportionment rather than allocation.

We respectfully submit that this analysis likewise suffers from two weaknesses. First, the commercial domicile rule rests not on an "arbitrary fiction" but on the very benefits-and-protection standard that the *ASARCO* dissent recognizes as controlling. The commercial domicile "contributes . . . to the corporation in the way of opportunities, protection, and benefits. . . ." Sabine, *Constitutional and Statutory Limits on Power to Tax*, 12 Hastings L.J. 23, 33 (1960). Moreover, the taxpayer's activities with respect to investments not operationally connected to its business [9] ordinarily occur at the taxpayer's commercial domicile.[10] Accordingly, whether viewed from the standpoint of the general benefits that a state accords to its domiciliaries or from the standpoint of the protection that the state of domicile typically provides to the taxpayer's investment activities, the state of commercial domicile has the strongest claim for taxing investment income unrelated to a taxpayer's business operations.

Second, the Court's endorsement of the commercial domicile rule on the ground that the intangibles "had become 'integral parts of some local business'" where the taxpayer "maintained 'the actual seat of its corporate government'" was designed to draw a distinction between

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[9] If the investments were operationally connected to the taxpayer's business, they would, of course, give rise to apportionable income.

[10] That was clearly the case here. It is undisputed that Bendix's investment activities occurred at its commercial domicile in Southfield, Michigan. Stip. ¶¶ 7-30 (J.A. 154-61).

legal domicile and commercial domicile, not between intangibles that were integrally related to a unitary business and intangibles that served an investment function. In *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), on which the *ASARCO* dissenting opinion relies (458 U.S. at 347), the question was whether the state of a corporation's commercial domicile had the power to tax its intangibles in light of the traditional rule assigning intangibles to a corporation's legal domicile, (*i.e.*, the state of incorporation). The Court held that where a corporation maintained only the formal corporate records required by state law in its legal domicile, a "legal fiction" would "dominate realities" if the state of "the actual seat of its corporate government," the state in which "the management functioned," were denied the power to tax the intangibles. *Wheeling*, 298 U.S. at 211-12.

Consequently, the commercial domicile rule is wholly consistent with the view that a state's power to tax income from intangibles should depend on the benefits it confers upon the taxpayer or the activities associated with the generation of income. When a taxpayer's investments are not functionally related to business activities it carries on in other states, the state of commercial domicile plainly has the most powerful claim to such income. Indeed, the notion that assigning the income to the commercial domicile "disregard[s] the claims of other States in which the unitary business operates" (*ASARCO*, 458 U.S. at 347 (O'Connor, J., dissenting)) is predicated on the mistaken premise that the investments have an operational connection with such unitary business (in which case they would be apportionable even under *ASARCO* and *Woolworth*).

II. OVERRULING *ASARCO* AND *WOOLWORTH* WOULD DESTROY THE ESTABLISHED AND WORKABLE FRAMEWORK FOR DIVIDING CORPORATE INCOME AMONG THE STATES, AND ANY REPLACEMENT FOR THE PREVAILING CONSTITUTIONAL REGIME WOULD INCREASE COMPLEXITY, UNCERTAINTY, AND UNFAIRNESS

As we noted at the outset, the "overruling" of *ASARCO* and *Woolworth* envisions, at a minimum, the Court's embrace of a rule that would permit any state in which a corporation operates to tax an apportioned share of its intangible income. We further observed that it could well signify an even more dramatic revision of existing constitutional doctrine. In either event, by abandoning the fundamental principle that the in-state business must have a concrete operational connection with the activities the state seeks to tax, the Court would effectively be discarding not only *ASARCO* and *Woolworth* but also a century of precedent on which they rest.

The destruction of the constitutional framework that has long governed state taxation of interstate business would, however, mark only the beginning of the havoc that overruling *ASARCO* and *Woolworth* would wreak. Any new constitutional regime that the Court might plausibly construct out of the ruins of the old would engender problems at least as troublesome as those that it may pereceive in the existing system. Indeed, it could take another century to iron out the wrinkles in the Court's brave new world of state taxation before some 21st century Supreme Court abandons it for yet a "fairer" system of allocating and apportioning income among the states. Moreover, the overruling of *ASARCO* and *Woolworth* would have the immediate impact of rendering unconstitutional the laws of two-thirds of the taxing states, which allocate investment income to the commercial domicile (see Appendix), unless the Court is also willing to

tolerate rampant multiple taxation that will seriously jeopardize the national economy.

A. A Constitutional Regime Permitting States To Apportion All Of A Corporation's Intangible Investment Income Would Elevate Form Over Substance, Exacerbate Problems Of Fair Apportionment, And Render The Existing Taxing Schemes Of Most States Unconstitutional

If this Court were to overrule *ASARCO* and *Woolworth* and hold that all of a corporation's intangible investment income was apportionable regardless of the connection between such income and the taxpayer's in-state business activities, the resulting constitutional landscape would display the following features.

1. *Form Versus Substance*

Form rather than substance would govern the question whether income was apportionable. To return to the example that Allied offered at the first oral argument of this case, suppose that a corporation domiciled in Illinois operates a beauty parlor business through a division in New Jersey and a parking lot business through a division in California. Suppose further that the beauty parlor business has nothing to do with the parking lot business, other than the fact that both businesses are owned by a single corporation. If the corporation sold its parking lot business, New Jersey plainly could not include in the corporation's New Jersey apportionable tax base the income from that sale because it was derived from a "discrete business enterprise" (*Mobil,* 445 U.S. at 439) that was "distinct in any business or economic sense" (*id.*) from the corporation's activities in New Jersey.

Let us now assume, however, that the corporation decides to incorporate the California parking lot division in a separate subsidiary. The facts remain identical to those in the preceding paragraph except that now the

corporation sells the stock of the California subsidiary and realizes a gain on that sale. If all intangible investment income were apportionable regardless of the connection between such income and the taxpayer's in-state business activities, then New Jersey could include the income from the sale despite the fact that there had been no change in substance from the situation in which New Jersey was constitutionally precluded from including such income in the taxpayer's apportionable tax base.

Moreover, tax consequences would vary depending on whether investments were made in tangible or intangible assets. If the corporation decided to make a long-term investment for capital appreciation and settled on raw land in a growing area of Florida, which it purchased for $10 million and later sold for $20 million, the $10 million capital gain from the sale would not be includable in the corporation's New Jersey apportionable tax base. If, however, the corporation had instead settled on the stock of a nonferrous metals company like ASARCO as the focus of its long-term investment of $10 million and had realized $10 million gain from the sale of ASARCO's stock, the gain would be fully includable in the corporation's New Jersey apportionable tax base under a constitutional regime that sanctioned the apportionment of all intangible income. Yet the difference in the substance of the two transactions from New Jersey's vantage point is impossible to discern.

To be sure, the Court could eliminate the form-over-substance problem described above by holding that all income of a corporation doing business in a state is apportionable, regardless of the form in which it is received or its relationship to the taxpayer's operations in the state. Such an approach, however, would constitute an even more drastic restructuring of the constitutional framework governing state taxation and would create additional problems that we address below. See pp. 31-34 *infra*.

2. *Fair Apportionment*

If this Court were to hold that all of a corporation's intangible investment income is apportionable regardless of the connection between such income and the taxpayer's in-state business activities, the problem of fair apportionment would be greatly exacerbated, courts would become embroiled in endless controversies over the propriety of state tax apportionments, and the administrative complexity of state tax audits would increase dramatically.

As this Court has frequently recognized, "an apportionment formula must, under both the Due Process and Commerce Clauses, be fair." *Container*, 463 U.S. at 169 (citing cases). The first component of fairness is "internal consistency." *Id.* "The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.*

If intangible investment income were automatically included in a taxpayer's apportionable tax base, state tax apportionments would routinely violate the "external consistency" principle. The apportionable tax base would include large sums of intangible investment income unrelated to the taxpayer's unitary business activities. Yet the apportionment factors, typically comprised of the taxpayer's real and tangible personal property, its payroll, and its sales (1 Multistate Corporate Income Tax Guide (CCH) ¶ 146 (1992)), would principally "reflect the relative contributions of the activities in the various States to the production of the total unitary income." *Butler Bros.*, 315 U.S. at 509 (citation and internal quotation marks omitted). They would not "reflect a reasonable sense of how [the taxpayer's intangible] income is generated." [11]

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[11] Intangible property is almost universally excluded from the property factors of state tax apportionment formulas for general

The constitutional infirmity in such a theoretical mismatch between the apportionable tax base and the apportionment factors was recognized by Justice Stevens in his dissenting opinion in *Mobil*:

> [I]t is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income.

Mobil, 445 U.S. at 459 (Stevens, J., dissenting); [12] see also *People ex rel. Alpha Portland Cement Co. v. Knapp*, 230 N.Y. 48, 58-59, 129 N.E. 202, 206 (1920) (Cardozo, J.) (including income from nondomiciliary corporation's out-of-state intangible investments without reflecting such investments in the apportionment factors is unconstitutional).

The root of the problem lies in the fact that state income tax apportionment formulas were never designed to deal with large quantities of investment income, which has traditionally been excluded from the apportionable tax base and assigned to the taxpayer's state of commercial domicile. See Appendix. Consequently, if this Court were to discard the constitutional rules confining the apportionable tax base to income derived from a taxpayer's business activities, it would necessarily spawn a host of issues relating to the "external consistency" of state tax apportionments.

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business corporations. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 152 (1992). Similarly, receipts from sales of intangibles are usually excluded from the sales factor when the intangible income cannot be attributed to any income-producing activity of the taxpayer. *See* MTC Reg.IV.18.(c), reprinted in 2 CCH Multistate Corporate Income Tax Guide (CCH) ¶ 8387 (1991).

[12] The Court in *Mobil* never addressed the merits of this question, holding that it was not properly raised below. *Id.* at 441 n.15.

Courts would have to confront issues such as the following: how intangibles should be reflected in apportionment formulas; whether the concepts underlying formulas designed to apportion operating income are appropriate for formulas employed to apportion intangible income; whether there should be one rule for intangible income from passive investments and another for intangible income from functionally integrated, controlled subsidiaries; whether, in the latter case, taking account of all or a portion of the subsidiaries' factors would be proper, and, if proportional inclusion were deemed to be proper, whether the proportional inclusion should depend on the extent of ownership, the percentage of the subsidiaries' earnings and profits that were paid out as dividends, or other factors; and so on. See Amicus Brief of American Home Products Corp., et al.

These questions would also significantly complicate state tax administration. Taxpayers and state tax personnel would be required to devote considerable time and energy to the task of modifying apportionment factors to take appropriate account of the particular intangible income that was included in the tax base. The difficulties would be compounded by the different positions that tax administrators in various states would no doubt take with respect to the appropriate treatment of intangibles. And, unless this Court were to reconsider its opinion in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), which permitted the states to adopt inconsistent income tax apportionment formulas, the inevitable result would be an increase in multiple taxation as states experimented with various approaches to the apportionment of intangible income.

3. *The Constitutional Condemnation of Existing State Tax Laws*

Perhaps the most mischievous consequence of a constitutional rule sanctioning the apportionment of all intangible income is that it would leave the existing structure

of state tax laws in shambles. As noted above (at 14-17), the states have over the years developed a workable and substantially uniform system of state taxation of investment income predicated in large part on the constitutional guidelines that the Court has established in this domain. Under this system, intangible investment income that is not integrally related to the taxpayer's regular trade or business is generally allocated to the taxpayer's commercial domicile. The Court's overruling of *ASARCO* and *Woolworth* to permit nondomiciliary states to tax investment income not integrally related to a taxpayer's business would destroy this system.

If investment income were held to be generally apportionable by nondomiciliary states, this Court's decisions strongly suggest that the domiciliary state would be precluded from allocating such income to itself on an unapportioned basis. In *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952), the Court held that a domiciliary state lacked the power to tax personal property on an unapportioned basis when other states had the power to tax the property on an apportioned basis:

> The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations . . . .

Id. at 384-85. *See also Central Railroad Co. of Pennsylvania v. Pennsylvania*, 370 U.S. 607, 612 (1962); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 447 (1979) ("[t]he corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full"). Most recently, the Court declared in *Mobil* that "[t]axation by apportionment and taxation by allocation to a single situs are theoretically incommensurate" (445 U.S. at 444), defending against a multiple taxation claim its holding that the power of the domiciliary state to tax income from intangibles should not be "exclu-

sive" (*id.* at 446) when other states had power to tax the income on an apportioned basis.

The tax laws of the vast majority of states allocate investment income to the commercial domicile. These laws could not pass constitutional muster if nondomiciliary states were able to tax the investment income on an apportioned basis. Moreover, it is the *risk* and not solely the actuality of multiple taxation that deprives the domiciliary state of the power to allocate to itself income when other states have the power to apportion such income. *Mobil*, 445 U.S. at 444; see also *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 228-29 (1980). Thus granting nondomiciliary states the power to tax intangible income on an apportioned basis would bar domiciliary states from allocating such income, although many states' laws currently so provide.[13]

Furthermore, if we are wrong in our understanding of the Court's doctrine forbidding domiciliary states from allocating income that is apportionable by other states, the states' existing tax laws might survive but interstate commerce would suffer grievous harm. Under a constitutional regime in which a corporation's intangible income was allocable in full to the state of its commercial domicile

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[13] In the short run, therefore, until the states adjust their laws to take advantage of their newly recognized taxing powers, a decision permitting nondomiciliary states to tax all intangible income on an apportioned basis could pose serious problems for most states. While the Constitution would permit the states to tax an apportioned share of all intangible investment income, the state statutes would bar them from doing so, because such income, if not related to the taxpayer's business activities in the state, would be allocable to other states. Conversely, while the state statutes would authorize the states to allocate to themselves intangible investment income of domiciliary taxpayers, the Constitution would bar them from doing so, because such income would be apportionable elsewhere. This is just another example of the untoward and unexpected consequences that would ensue from the Court's abandonment of the established constitutional framework delineating state tax power.

yet at the same time apportionable in all of the states in which it operated, a multistate corporation would be subject to tax on close to 200 percent of its investment income. There would therefore be "an inexorable hydraulic pressure" (*American Trucking Ass'ns, Inc. v. Scheiner*, 483 U.S. 266, 286 (1987)) for corporations to confine their operations to one state in frustration of the central purposes of the Commerce Clause.

B. A Constitutional Regime Permitting States To Apportion All Of The Income Of A Corporation Operating In The State Regardless Of The Connection Of The Income-Producing Activities To The State Would Create A System At War With Basic Notions Of Fairness And Common Sense And Would Require The Court To Assume A Much More Active Role In Reviewing State Tax Apportionments

We have shown above that a rule permitting the apportionability of income without regard to its relationship to the taxpayer's business activities in the state cannot be confined to intangible income without creating nonsensical distinctions between income from tangible and intangible assets. See p. 24, *supra*. Thus any principled "overruling" of *ASARCO* and *Woolworth* would have to abandon the unitary business principle altogether for purposes of determining apportionability. The apportionability of income would depend simply on whether it was earned by a corporation that is subject to the state's taxing jurisdiction. Indeed, counsel for New Jersey candidly conceded this point during the first oral argument of this case.[14]

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[14] QUESTION: I guess I don't know what you mean by a unitary business. I guess—is every business that's owned by the same company part of a unitary business?

MS. HAMILL: Yes.

QUESTION: Is that the only condition?

MS. HAMILL: Yes. Would say because—

[Continued]

If this Court were to scrap the doctrine that "the linchpin of apportionability . . . is the unitary-business principle," Mobil, 445 U.S. at 439, and replace it with the doctrine that the "linchpin of apportionability is ownership," the consequences would be as unpalatable as those resulting from the abandonment of the unitary business principle solely for intangible income.

1. *Misattribution of Income*

In addition to the problems of fair apportionment identified above (see pp. 25-27), a constitutional regime that allowed states to apportion all income earned by corporations subject to their jurisdiction would create severe problems of income misattribution. To return to the example of a corporation with a beauty parlor business in New Jersey and an unrelated parking lot business in California, suppose that the corporation's apportionment percentage was 50 percent each for California and New Jersey, based on its property, payroll, and sales in the respective states. Suppose further that the parking lot business generated $1 million of income, whereas the beauty parlor business broke even. Under an everything-is-apportionable regime, New Jersey could require that the corporation include the full $1 million in its apportionable tax base and would be entitled to tax $500,000 of income generated by the California parking lot business, even though New Jersey had no meaningful connection to the activities that produced the income. By the same token, although the full $1 million was earned

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[14] [Continued

QUESTION: So there's really no inquiry to be made at all.
MS. HAMILL: That's—yes—
QUESTION: So long as it's owned by the same corporation.
MS. HAMILL: Yes, that's right.
QUESTION: That's what I thought.
MS. HAMILL: That is New Jersey's position. And I'd like to say otherwise. . . .

Tr. of Oral Argument at 31-32.

from California activities, California would be deprived of the right to tax the half apportioned to New Jersey. A dollar more of apportionable income for New Jersey would mean a dollar less for California.

The blatant unfairness of such a taxing system is self-evident. Not only is the New Jersey taxpayer saddled with a tax burden that bears no relationship to the income earned in the state, but California, the state with the legitimate claim to the portion of the tax base that is arbitrarily assigned to New Jersey, is stripped of the right to tax its fair share of the taxpayer's earnings. Moreover, the fact that half of any New Jersey beauty parlor income would have been taxed by California hardly cures the problem. Indeed, the Court has recognized the dangers inherent in a scheme of apportionment that loses sight of the fact that it is justified only by the difficulty of identifying the source of income derived from in-state and out-of-state activities that are inextricably interconnected:

> We can accept the premise that apportionment is permitted only when precise geographic measurement is not feasible, *for to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues.*

Trinova Corp. v. Michigan Dep't of Treasury, 111 S. Ct. 818, 829 (1991) (emphasis added).

Several Justices likewise recognized the same danger at the first oral argument in this case. One Justice, addressing a hypothetical involving a taxpayer's profitable Tennessee forest products business with no connection to its unprofitable New Jersey operations, observed: "I don't know why they should have to pay for the losses in New Jersey. The whole business is just run out of Tennessee, it has no connection with the other states." Tr. of Oral Argument at 44. Another Justice pointed out that where you have "an entirely separate operation . . . the reason

why the unitary business concept was developed simply doesn't apply." *Id.* at 37-38.

The utterly irrational results emanating from an everything-is-apportionable regime—results that are alien to rudimentary concepts of fairness and logic—warrant its dismissal out of hand.

2. *Increased Judicial Monitoring of State Tax Apportionment*

If the Court nevertheless accepted New Jersey's request to replace the unitary business principle with ownership as the "linchpin of apportionability," the manifestly unfair results of the kind described above would undoubtedly intensify the pressure on this Court, and on courts generally, to police more closely the fairness of state tax apportionments. Without the unitary business principle to serve as a prophylactic device to confine the tax base to income arising from a related set of activities, there would inevitably be an increase in state tax apportionments that bore no reasonable relationship to the taxpayer's activities in the state. Consequently, courts would increasingly be compelled to adjudicate the question whether particular apportionments were "fair."

By adopting a rule of apportionability that would necessitate increased judicial involvement in state tax apportionment controversies, the Court would be undoing all it has accomplished over the past 15 years to establish workable guidelines governing state tax apportionment and to limit its own role in this area. The Court's decisions in *Moorman*, *Mobil*, *Exxon*, *ASARCO*, *Woolworth*, and *Container* reflect a coherent vision of the essential constitutional limits on the states' power to impose apportioned state income taxes and on the Court's role in enforcing them. We have delineated these limits in considerable detail both here and in our earlier briefs, and there is no need to do so again at this juncture. If the Court were to abandon the "well established" legal principles bearing on state tax apportionment, it would

be inviting an outpouring of litigation in which it would inevitably become entangled.

C. If *ASARCO* And *Woolworth* Are Overruled, The Principles Governing State Taxation Of Multistate Corporations Should Be Designed To Assure Rationality In State Taxing Schemes, Avoid Duplicative Taxation, And Prevent Misattribution Of Income

If this Court were to overrule *ASARCO* and *Woolworth*, the Court should seek to avoid the problems we have identified above that will inevitably result from abandoning the existing constitutional regime governing state taxation of multistate business. In particular, we would urge the Court to make it clear that substance rather than form must determine state tax liabilities; that formulas for apportioning income must fairly reflect the way in which apportionable income is earned; that no state is entitled to allocate entirely to itself income that is apportionable by other states; and that the claims of unfair apportionment must be accorded heightened scrutiny in light of the increased risk of distortion resulting from the broadening of the apportionable tax base. We submit that the existing regime accords with these principles far better than any conceivable alternative.

III. CONSIDERATIONS OF *STARE DECISIS* STRONGLY FAVOR REAFFIRMATION OF *ASARCO* AND *WOOLWORTH*

Against this background, *ASARCO* and *Woolworth* should be reaffirmed for the best of reasons: they were correctly decided, stating the rule that most fully effectuates the purposes of the constitutional proscription on extraterritorial taxation. But even if the Court disagrees with that proposition—even if, in other words, it is now of the view that the questions presented in *ASARCO* and *Woolworth* would be decided differently today were they matters of first impression—considerations of *stare decisis* should lead the Court to reaffirm the holdings of those decisions.

1. "The Court has said often and with great emphasis that 'the doctrine of *stare decisis* is of fundamental importance to the rule of law,'" serving a central role in the "fashioning and preserving [of] a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989), quoting *Welch v. Texas Highways & Public Transp. Dept.*, 483 U.S. 468, 494 (1987), and *The Federalist*, No. 78, p. 440 (H. Lodge ed. 1888). As Justice Harlan explained for the Court:

> Very weighty considerations underlie the principle that courts should not lightly overrule past decisions. Among these are the desirability that the law furnish a clear guide for the conduct of individuals, to enable them to plan their affairs with assurance against untoward surprise; the importance of furthering fair and expeditious adjudication by eliminating the need to relitigate every relevant proposition in every case; and the necessity of maintaining public faith in the judiciary as a source of impersonal and reasoned judgments.

Moragne v. States Marine Lines, Inc., 398 U.S. 375, 403 (1970). See, *e.g.*, *Payne v. Tennessee*, 111 S. Ct. 2597, 2609 (1991); *Vasquez v. Hillery*, 474 U.S. 254, 265 (1986); *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980) (plurality opinion). As a consequence, the Court consistently has held that "any departure from the doctrine of *stare decisis* demands special justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984).

The Court also has made clear the factors that bear on this inquiry. For over a century the Court has emphasized that "[c]onsiderations in favor of *stare decisis* are at their acme in cases involving property and contract rights" (*Payne*, 111 S. Ct. at 2610); holdings in those areas will not be disturbed "except for the most cogent reasons, certainly not because of subsequent doubts as to their soundness." *National Bank v. Whitney*, 103 U.S. 99, 102 (1880). And as a general matter, the only

"detours from the straight path of *stare decisis* in [the Court's] past have occurred * * * when the Court has felt obliged 'to bring its opinions into agreement with experience and with facts newly ascertained.'" *Vasquez*, 474 U.S. at 266, quoting *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 412 (1932) (Brandeis, J., dissenting). That typically has been so only when the decision in question was "decided before some important developments in the constitutional law" (*Alabama v. Smith*, 490 U.S. 794, 802 (1989)) and therefore did "not fit into [the Court's current] analytical framework" (*Collins v. Youngblood*, 110 S. Ct. 2517, 2521 (1990)), or otherwise "has caused confusion" in the courts. *Collins*, 110 S. Ct. at 2722. See, *e.g.*, *Patterson*, 491 U.S. at 173; *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 342-343 (1989); *Arkansas Electric Cooperative Co. v. Arkansas Public Utility Comm'n*, 461 U.S. 375, 391 (1983); *Moragne*, 398 U.S. at 404-405.

2. All of these considerations plainly militate against a departure from precedent here. *First*, the rules at issue in *ASARCO* and *Woolworth* involve property interests where "[t]he confidence of people in their ability to predict the legal consequences of their actions is vitally necessary to facilitate the planning of primary activity." *Moragne*, 398 U.S. at 403. The value of stability in the principles governing taxation (and the reliance of taxpayers on those principles) is manifest. A host of every taxpayer's business decisions—relating both to its plans for the future and to conduct undertaken in the past (such as its acquisition of intangible property that is now producing dividend income or that is expected to produce a capital gain on resale)—have been affected by the constitutional limits on state taxing authority. Cf. *Helvering v. Griffiths*, 318 U.S. 371, 402-403 (1943). Even leaving aside questions of retroactivity,[15] changing those limits

[15] According retroactive application to a decision overruling *ASARCO* and *Woolworth* would, of course, greatly magnify its

and upsetting those business judgments surely defeats "the broader societal interests in evenhanded, consistent, and predictable application of legal rules." *Thomas*, 448 U.S. at 272 (plurality opinion).

The defeat of reliance interests, moreover, would not be limited to the taxpayer side of the equation. As we have explained (at pages 27-30, *supra*), the taxing schemes of the 30 states that allocate to themselves 100% of their domiciliaries' intangible nonbusiness income (see App., *infra*) would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth*. And the budgets of these states (again even leaving aside any question of retroactivity)—their plans for providing services, setting the rates of other taxes, and so on—are based on assumptions about revenue that derive from the existing constitutional rules. The disruption that would follow from the setting aside of those rules may be easily imagined.

Second, this is not a case where there is "difficulty [in] harmonizing" *ASARCO* and *Woolworth* with the rest of this Court's jurisprudence. To the contrary, as we explain above, those decisions are, if not compelled by, at least wholly consistent with the Court's broader Due Process and Commerce Clause doctrine. Nor are they in tension with any subsequent rulings; *Container Corp.*, the only more recent decision to address the unitary business principle in any detail, took pains to demonstrate the consistency of its holding with the reasoning of *ASARCO* and *Woolworth*. See 463 U.S. at 176-177 n.15, 177 n.16, 178-180. By the same token, those decisions have not spawned

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disruptive effects. We argue below that such a decision should not be applied retroactively. If the Court were to find retroactivity constitutionally compelled, however, the extraordinary dislocation that would ensue is further reason not to overrule *ASARCO* and *Woolworth* in the first place. Cf. *James M. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2450 (1991) (Blackmun, J., concurring in the judgment); *id.* at 2451 (Scalia, J., concurring in the judgment).

confusion or uncertainty. In fact, as we note in our opening brief (at 28 n.12), virtually all state courts—with the exception of the one below—have had little difficulty in faithfully adhering to the doctrine of *ASARCO* and *Woolworth*.

Finally, none of the objective indicia that suggest the propriety of departing from precedent is present in this case. *ASARCO* and *Woolworth* were not "decided by the narrowest of margins." *Payne*, 111 S. Ct. at 2611. They have neither "been questioned by members of the Court in later decisions" nor have they "defied consistent application by the lower courts." *Ibid.* And they certainly were not "judicial atrocities" (*Arkansas Electric Cooperative*, 461 U.S. at 273) that may be lightly discarded. In such circumstances, there is no principled ground on which *ASARCO* and *Woolworth* may be overruled without also opening to relitigation "every relevant proposition in every case." *Moragne*, 398 U.S. at 403.

IV. IF *ASARCO* AND *WOOLWORTH* ARE OVERRULED, THE DECISION SHOULD NOT BE RETROACTIVE

If the Court chooses to overrule *ASARCO* and *Woolworth*, it must face the question whether to compound the resulting chaos in state tax administration by applying its decision retroactively. Doing so would have dramatic consequences. It would free states like New Jersey, which have had statutes on the books purporting to permit the taxation even of those portions of a nondomiciliary's income that are not related to its in-state activities, to seek back taxes from all nondomiciliary taxpayers over whom they have jurisdiction. At the same time, as we explain above, the taxing schemes of states that allocate to themselves 100% of their domiciliaries' intangible income (or of discrete portions of that income) likely would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth*; if such a decision were retroactive, the 30 states in that category could be required, under the

rule of *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 110 S. Ct. 2238 (1990), "to provide meaningful backward-looking relief" in the form of refunds. *Id.* at 2247.

Whether such unsettling and disruptive retroactive consequences are avoidable when the law takes a radical change in direction, of course, is a matter that has closely divided the Court in recent years. In *American Trucking Ass'ns, Inc. v. Smith*, 110 S. Ct. 2323 (1990) ("ATA"), the plurality was of the view that decisions announcing new rules of law do not necessarily "appl[y] to conduct or events that occurred before the date of the decision" (*id.* at 2330), explaining that retroactivity in such circumstances is governed by the three-part "*Chevron Oil* test." See *id.* at 2331, referring to *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). The *ATA* dissent, in contrast, concluded that the Court must apply its current understanding of the law in every case, while adding that equitable remedial principles may be invoked in certain cases to limit the relief available to the prevailing party when a decision has been overruled. See *ATA*, 110 S. Ct. at 2347-2348 (Stevens, J., dissenting). As matters now stand, four current Members of the Court have taken the position that new rules of law may, in appropriate cases, be applied prospectively (see *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2449 (1991) (White, J., concurring in the judgment); *id.* at 2451 (O'Connor, J., dissenting); *ATA*, 110 S. Ct. at 2336-2343 (plurality opinion); three evidently are of the view that new rules must be applied retroactively in all cases (see *James Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment); *ATA*, 110 S. Ct. at 2350-2356 (Stevens, J., dissenting)); one has expressly left open the question whether "pure prospectivity" ever is permissible (see *James Beam*, 111 S. Ct. at 2448 (opinion of Souter,

J.); one (Justice Thomas) has had no occasion to address the issue.[16]

This disagreement between the *ATA* plurality and dissent is of crucial importance here. If the Court overrules *ASARCO* and *Woolworth*, the *ATA* plurality's approach would then require application of the *Chevron Oil* test; since (as we demonstrate below) that test dictates nonretroactivity, the new post-*ASARCO* rule announced in this case would not be applied to the parties here and New Jersey would be precluded from collecting taxes for periods prior to the Court's decision. The approach taken by the *ATA* dissent, in contrast, would apply the post-*ASARCO* rule into the past and therefore might well permit New Jersey to collect the taxes at issue.[17] We

[16] A plurality of the Court in *James Beam* concluded that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." 111 S. Ct. at 2446 (opinion of Souter, J.). See *id.* at 2448-2449 (White, J., concurring in the judgment). But that would not be the situation here, of course, since no one has yet gotten the benefit of a post-*ASARCO* rule. As a consequence, prospectivity in this case (should *ASARCO* and *Woolworth* be overruled) would not involve the " 'selective application of new rules,' " a prospect that substantially underlay the *ATA* dissent. *See* 110 S. Ct. at 2350 (Stevens, J., dissenting), quoting *Griffith v. Kentucky*, 479 U.S. 314, 323 (1987).

[17] The *ATA* dissent acknowledged that, even when new rules are applied retroactively, the Court may retain the discretion to limit the retroactive *remedies* available under those rules. Here, the availability of such remedies should *ASARCO* and *Woolworth* be overruled would be determined in the first instance by state law rather than federal remedial principles (see *James Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.); as a consequence, if the Court discards those precedents and concludes that the new rule should be applied retroactively, it should remand rather than affirm so that the New Jersey courts have an opportunity to decide whether state law permits the collection of taxes in these circumstances. It also is possible that the Due Process Clause might preclude the retroactive collection of taxes in a case such as this one. Cf. *McKesson*, 110 S. Ct. at 2252 n.23. These questions need not be confronted if the Court adopts the approach of the *ATA* plurality.

therefore turn to the controlling question here: whether to view retroactivity "as a choice of law rule [or] . . . as a remedial principle." *ATA*, 110 S. Ct. at 2348 (Stevens, J., dissenting).

A. The Court Should Apply The *Chevron Oil* Test In Determining Whether New Principles Of Law Control The Case Before It

We submit that the *ATA* plurality's approach better accords both with this Court's precedents and with the general understanding of retroactivity. The issues were addressed at length by the Court in *James Beam* and *ATA*, and we will not rehearse the arguments here. In our view, however, several points bear special emphasis.

1. As an initial matter, whether or not the *ATA* dissent's characterization of retroactivity as a matter of remedy is, strictly speaking, consistent with the Court's prior holdings, that characterization appears out of step with the Court's past understanding of its decisions. The Court's civil rulings limiting retroactivity typically contain language indicating that "the decision will not apply" to past conduct, or that "we will apply our decision in this case prospectively." *Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969). See also, *e.g.*, *Chevron Oil*, 404 U.S. at 106-107 ("'a holding of nonretroactivity'"); *Phoenix v. Kolodziejski*, 399 U.S. 204, 214 (1970) ("[o]ur decision in this case will apply only to" specified conduct). Cf. *Heckler v. Mathews*, 465 U.S. 728, 746 (1984) ("We have recognized, in a number of contexts, the legitimacy of protecting reasonable reliance on prior law even when that requires allowing an unconstitutional statute to remain in effect for a limited period of time"). This sort of language—stating that "a decision will not apply" to past conduct—surely is most naturally read as meaning that the *rule* announced in that decision will not apply. The lower courts, practitioners, and commentators therefore have understood the Court's retroactivity decisions to state "a doctrine or set of rules for determining when

past precedent should be applied to a case before the court." *ATA*, 110 S. Ct. at 2350 (plurality opinion). See *id.* at 2340 & n.2 (citing commentary).

The reasons that have impelled the Court to adopt that approach to retroactivity are manifest. Public officials and the citizenry at large are entitled to rely on this Court's statements of the law, and "[t]he utility of [the Court's] retroactivity doctrine in cushioning the sometimes inequitable and disruptive effects of law-changing decisions is clear." *ATA*, 110 S. Ct. at 2342 (plurality opinion). There accordingly is no compelling reason to depart from the long-settled understanding that, " '[w]here a decision of this Court could produce substantial inequitable results if imposed retroactively, there is ample basis in [the Court's] cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity.' " *Chevron Oil*, 404 U.S. at 107, quoting *Cipriano*, 395 U.S. at 706.

It nevertheless has been suggested that the disruptive effects of mandatory retroactivity actually serve valuable purposes by discouraging departures from precedent and acting as a "check[] upon judicial law making." *James Beam*, 111 S. Ct. at 2451 (Scalia, J., concurring in the judgment). For our part, however, we question whether society is well-served by a rule that puts the Court to the choice of, on the one hand, retaining in force a concededly incorrect understanding of the Constitution (a choice that is particularly unpalatable to those who believe that judges should make law "as though they were 'finding' it" (*ibid.* (emphasis omitted)), or, on the other, causing potentially intolerable disruptive effects by its holdings.[18]

[18] In any event, the *ATA* dissent itself acknowledged that the Court often will be able to cushion the impact of its decisions through the choice of a nonretroactive *remedy*. The dissent's approach therefore is a very imperfect check upon judicial action: it is difficult to see how the force of precedent is significantly furthered by a choice of law rule that discourages the overruling of

2. The principal challenge to the approach of the *ATA* plurality has been grounded upon the suggestion that limiting retroactivity somehow is inconsistent with the judicial role. See *James Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment). But there plainly is no Article III or other constitutional defect in the *ATA* plurality's approach. The Court repeatedly has held that there is no constitutional requirement of retroactivity. See, *e.g.*, *United States v. Johnson*, 457 U.S. 537, 543 (1982), citing *Great Northern Ry Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, 364 (1932). And the formal notion that judges "find" rather than "make" rules does not dictate retroactivity; the Court consistently has refused to " 'indulge in the fiction that the law now announced has always been the law.' " *Chevron Oil*, 404 U.S. at 107 (citation omitted). See, *e.g.*, *Williams v. United States*, 401 U.S. 646, 651 (1971) (plurality opinion); *Linkletter v. Walker*, 381 U.S. 618, 622 n.3 (1965).

There undeniably is, moreover, a real controversy between the parties in a case such as this one (the State wants Bendix's money and Bendix does not believe it should have to pay), whatever the Court's ultimate choice of law. And a holding of nonretroactivity is hardly advisory; the Court's opinion in such a case simply explains its rationale for choosing a particular rule and applying that rule (or failing to apply it) to particular facts. A decision of that sort is similar in principle to, and relies upon the same considerations of policy as, a conclusion that a prior holding was wrongly decided but should not be overruled so as to protect the litigants' (and the public's) reliance interests. See, *e.g.*, *Flood v. Kuhn*, 407 U.S. 258, 282-284 (1972).

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decisions only in those areas where the Court fortuitously has no remedial discretion. Allowing the nature of the choice of law rule to be dictated by the perceived value of retroactivity in those cases would have a very small practical tail wagging a very large theoretical dog.

In fact, as the *ATA* plurality explained, principles of nonretroactivity long have been understood to be an element of the doctrine of *stare decisis*. 110 S. Ct. at 2340-2341, citing *Sunburst*, 287 U.S. at 364 (Cardozo, J.). Certainly, if it is appropriate for the Court to protect the public's expectation interests by declining to overrule a decision that is thought to have been wrongly decided, it is equally proper to allow courts, by means of prospective overruling, "to respect the principle of *stare decisis* even when they are impelled to change the law in light of new understanding." *ATA*, 110 S. Ct. at 2341 (plurality opinion). Justice Scalia offered a related analysis in *ATA*, where he concluded that a Justice who disagrees with a decision that overruled precedent may decline to apply that decision to conduct that had been undertaken in reliance on the precedent; in such circumstances, *stare decisis* principles permit a departure from the more recent decision so as not to "upset * * * settled expectations." *Id.* at 2345 (Scalia, J., concurring in the judgment) (emphasis omitted). We add only that, if Justice Scalia's understanding of *stare decisis* is correct—and we believe it is—it is not at all clear why it should be inconsistent with the judicial role for a judge who *agrees* with a decision to decline to apply that decision's rule so as to protect those same expectation interests.

There is nothing new in this conclusion: the Court consistently has taken into account such considerations "of a practical sort" in settling the retroactive reach of its decisions. *James Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.). In civil cases, for example, the Court will not allow "a new rule [to] reopen the door already closed" by principles of res judicata or by statutes of limitations, even though those limits on retroactivity are in some sense "arbitrary" (*id.* at 2446); the Court denies complete retroactive effect to the new rule so as to advance independent interests in finality. See *id.* at 2447. The Court has applied the same sort of practical judgment in the application of retroactivity in the setting

of habeas corpus, adopting an approach, first propounded by Justice Harlan in *Mackey v. United States*, 401 U.S. 667, 675 (1971) (opinion of Harlan, J.), that accords most constitutional decisions nonretroactive effect in habeas proceedings. *Teague v. Lane*, 489 U.S. 288, 299-310 (1989) (plurality opinion). Again, if considerations of finality and reliance may justify disregard of "current constitutional law" in such proceedings (*Mackey*, 401 U.S. at 686 (opinion of Harlan, J.)), there is no reason to find it inconsistent with the judicial function for a judge, looking to similar policies, to decline to apply new law in a case such as this one.

B. The *Chevron Oil* Test Would Preclude Retroactive Application Of A Decision Overruling *ASARCO* and *Woolworth*

If limits on retroactivity are permissible, it remains to apply *Chevron Oil*'s three-part test here. The test's elements have become familiar:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, * * * we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we [must] weigh[] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

Chevron Oil, 404 U.S. at 106-107 (citations and internal quotation marks omitted). If the Court were to overrule *ASARCO* and *Woolworth* here, this case is a paradigm of one in which the decision should not be given retroactive effect.

1. By definition, the first element of *Chevron Oil* would be satisfied if the Court set aside the holdings of *ASARCO* and *Woolworth*. In such circumstances, the Court plainly would have "overrul[ed] clear past precedent on which litigants may have relied"—a conclusion that draws added force from the recognition that, as we explain above, *ASARCO* and *Woolworth* themselves rested squarely on a long line of this Court's decisions. Such a holding, moreover, would not have been foreshadowed by intervening decisions. To the contrary, in *Container Corp.* the Court discussed the holdings of *ASARCO* and *Woolworth* in considerable detail without so much as hinting at dissatisfaction with their reasoning. See 463 U.S. at 176-177 n.15, 177 n.16, 178-180. And just last Term the Court quoted from *ASARCO* with approval. *See Trinova Corp.*, 111 S. Ct. at 834. The break with existing law should *ASARCO* and *Woolworth* be overruled accordingly would be clear.

2. The second prong of the *Chevron Oil* test also points away from retroactivity. If there has been a clear break in the law, this element of the formula looks to whether retroactivity nevertheless is necessary "to deter deliberate violations or grudging compliance" with the law (*Florida v. Long*, 487 U.S. 223, 230 (1988)), or otherwise to advance federal policies. See, *e.g.*, *id.* at 236-237; *Chevron Oil*, 404 U.S. at 107-108. That is not the case here. There is absolutely no reason to suppose that retroactive application would assist in "ensur[ing] compliance with [the Court's] decision[]" (*Long*, 487 U.S. at 235) on the part either of taxpayers or of state officials. And the purpose of the Due Process Clause in this setting—assuring that states do not tax values with which they have no connection—"is fully served if States are, from the date of [a decision overruling *ASARCO* and *Woolworth*], prevented from enacting [unconstitutional] tax schemes." *James Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting).

3. Finally, the equities here would cut powerfully against retroactivity. A great many firms that justifiably believed themselves to be in compliance with state tax law—and that made investment and other spending decisions accordingly—would suddenly find themselves with substantial back tax bills should a decision overruling *ASARCO* and *Woolworth* be made retroactive. Other firms that allocated and paid tax on 100% of the investment income to their state of commercial domicile would be subject to substantial double taxation if their home-state tax years have been closed, but the same years remain open in many nondomiciliary states that would insist on taxing an apportioned share of the same income. The disruptive effect that such unanticipated (and unanticipatable) liability would have on those businesses and their employees is obvious.

At the same time, those allocation states whose tax systems would be rendered unconstitutional by a decision overruling *ASARCO* and *Woolworth* would face potentially devastating liability for refunds if the ruling were given retroactive effect. The untoward consequences of such liability often have been chronicled by the Court: it could "deplete the state treasury, thus threatening the State's current operation and future plans" (*ATA*, 110 S. Ct. at 2333 (plurality opinion)); it could necessitate tax increases (see *Arizona Governing Committee v. Norris*, 463 U.S. 1073, 1106-1107 (1983) (opinion of Powell, J.)); and it ultimately would fall on the public at large in the form of reduced services. See *James Beam*, 111 S. Ct. at 2456-2457 (O'Connor, J., dissenting). It also would impose very substantial administrative burdens, both on the states and on taxpayers. See *ATA*, 110 S. Ct. at 2333 (plurality opinion). In these circumstances, the almost incalculable disruption and confusion that would follow from extending backwards in time a decision overruling *ASARCO* and *Woolworth* would make retroactivity manifestly undesirable.

CONCLUSION

For more than a century, this Court has adhered to the bedrock principle that a state must have some concrete connection with out-of-state activities before it can exercise its tax power over such activities. A settled, workable, and substantially uniform system of state laws for taxing the income of multistate corporations evolved on the basis of that principle. No persuasive case has been made as to why this system should be abandoned and, as demonstrated above, the consequences of abandoning the system would be catastrophic. Moreover, if such a case had been made, a change of the magnitude that the Court is apparently contemplating is surely a matter that should be left to Congress. See Allied-Signal Rep. Br. 16-17.

Respectfully submitted,

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APPENDIX

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SITUS TO WHICH MULTISTATE CORPORATIONS MUST ASSIGN INCOME FROM INTANGIBLE PROPERTY WHEN IT IS DETERMINED TO BE ALLOCABLE FOR STATE TAX PURPOSES.[1]

STATE	SITUS OF ALLOCABLE INTANGIBLE INCOME[2]			CITATIONS
	INTEREST	DIVIDENDS	CAP. GAINS	
Alabama	CD	CD	CD	Ala. Admin. Code r. 810-3-31-.02(4)(b)(3), (c) (1988)
Alaska	CD	CD	CD	Alaska Stat. § 43.19.010, Art. IV, 6(c), 7 (1990)
Arizona	CD	CD	CD	Ariz. Rev. Stat. Ann. §§ 43-1136.C, -1137 (Supp. 1991)
Arkansas	CD	CD	CD	Ark. Code Ann. §§ 26-51-706(c), -707 (Michie 1987)
California	CD	CD	CD[3]	Cal. Rev. & Tax. Code §§ 25125(c), 25126 (West 1992)
Colorado	CD	CD	CD	Colo. Rev. Stat. Ann. § 24-60-1301, Art. IV, 6(c), 7 (West 1990)
Connecticut	n.a.	**	n.a.	Conn. Gen. Stat. Ann. § 12-218 (West Supp. 1991)

STATE	SITUS OF ALLOCABLE INTANGIBLE INCOME: INTEREST	DIVIDENDS	CAP. GAINS	CITATIONS
Delaware	where transaction took place	n.a.	n.a.	Del. Code Ann. tit. 30, § 1903(b) (1985)
Florida	CD	CD	CD	Fla. Stat. Ann. § 220.16(2)(c), (3) (West 1989)
Georgia	BS [4]	BS [4]	BS	Ga. Code Ann. § 48-7-31(c) (Supp. 1991)
Hawaii	CD	CD	CD [3]	Haw. Rev. Stat. §§ 235-26(c), -27 (1992)
Idaho	CD	CD	CD	Idaho Code § 63-3027(f)(3), (g) (1989)
Illinois	CD	CD	CD	Ill. Ann. Stat. ch. 120, ¶¶ 3-301(c)(2)(B), 3-303(b)(3) (Smith-Hurd 1991)
Indiana	CD	CD	CD	Ind. Code Ann. § 6-3-2-2(i)(3), (j) (West Supp. 1991)
Iowa	CD	CD	CD	Iowa Code Ann. § 422.33.2.a(1), (4) (West 1990)
Kansas	CD	CD	CD	Kan. Stat. Ann. §§ 79-3276(c), -3277 (1989)

Kentucky	CD	**	CD	Ky. Rev. Stat. Ann. § 141.120(5)(c), (6) (Michie/Bobbs-Merrill 1991)
Louisiana	BS/CD	BS/CD	BS/CD	La. Rev. Stat. Ann. § 47:287.93.A (West 1990)
Maine	n.a.	n.a.	n.a.	Me. Rev. Stat. Ann. tit. 36 § 5211 (West 1990 and Supp. 1991)
Maryland	n.a.	n.a.	n.a.	Md. Code Ann., Tax-Gen. § 10-402 (Supp. 1991)
Massachusetts	n.a.	n.a.	n.a.	Mass. Gen. Laws Ann. ch. 63, §§ 38, 38A, 42A (West 1988)
Michigan	*	*	*	Mich. Comp. Laws Ann. § 208.31 (West 1986 and Supp. 1991)
Minnesota	CD	CD	CD [3]	Minn. Stat. Ann. § 290.17.2 (West Supp. 1992)
Mississippi	CD	CD	BS/CD	Miss. Code Ann. § 27-7-23(c)(4) (1991)
Missouri	CD	CD	CD	Mo. Ann. Stat. § 32.200, Art. IV, ¶ 6(3), 7 (Vernon 1969)
Montana	CD	CD	CD	Mont. Code Ann. § 15-31-304(3)(c), (4) (1991)
Nebraska [5]	n.a.	n.a.	n.a.	Neb. Rev. Stat. § 77-2734.06 (1990)

STATE	SITUS OF ALLOCABLE INTANGIBLE INCOME			CITATIONS
	INTEREST	DIVIDENDS	CAP. GAINS	
Nevada	*	*	*	
New Hampshire	n.a.	n.a.	n.a.	N.H. Rev. Stat. Ann. § 77-A:3 (1991 and Supp. 1991)
New Jersey	n.a.	n.a.	n.a.	N.J. Stat. Ann. § 54:10A-6 (West 1986)
New Mexico	CD	CD	CD	N.M. Stat. Ann. § 7-4-7(c), -8 (Michie 1990)
New York [6]	n.a.	n.a.	n.a.	N.Y. Tax Law § 210 (McKinney 1986 and Supp. 1992)
North Carolina	CD	CD	CD	N.C. Gen. Stat. § 105-130.4(e)(3), (f) (1989)
North Dakota	CD	CD	CD	N.D. Cent. Code §§ 57-38.1-04, -06, -07 (1983 and Supp. 1991)
Ohio [7]	n.a.	n.a.	n.a.	Ohio Rev. Code Ann. § 5733.051(E), (F), (H) (Anderson 1991)
Oklahoma	BS/CD	BS/CD	BS/CD	Okla. Stat. Ann. tit. 68, § 2358.A.4.b (Supp. 1992)
Oregon	CD	CD	CD [8]	Or. Rev. Stat. § 314.635(3), .640 (1986 and Supp. 1990)

Pennsylvania	CD	**	CD	Pa. Stat. Ann. tit. 72, § 7401(3)(2)(a)(6)(C), (7) (1990)
Rhode Island	n.a.	n.a.	n.a.	R.I. Gen. Laws § 44-11-11, -14 (1988)
South Carolina	CD	CD	CD	S.C. Code Ann. § 12-7-1110, -1120(1), (2), (5) (Law. Co-op. 1976 and Supp. 1991)
South Dakota	CD	CD	CD	S.D. Codified Laws Ann. § 10-43-25.5 (1989)
Tennessee	CD	CD	CD	Tenn. Code Ann. § 67-4-810(c)(3), (d) (1989)
Texas	*	*	*	
Utah	CD	CD	CD	Utah Code Ann. §§ 59-7-308(3), -309 (1987)
Vermont	n.a.	n.a.	n.a.	Vt. Stat. Ann. tit. 32 § 5833 (1981 and Supp. 1991)
Virginia	n.a.	CD	n.a.	Va. Code Ann. § 58.1-407, -408 (Michie 1991)
Washington	*	*	*	
West Virginia	CD	CD	CD	W. Va. Code § 11-24-7(d)(2)(C), (3) (1991)
Wisconsin	n.a.	n.a.	n.a.	Wis. Stat. Ann. § 71.25(5)(a)(9), (10) (West 1984)
Wyoming	*	*	*	

LEGEND

CD=commercial domicile, *i.e.*, the principal place from which the trade or business of the taxpayer is directed or managed.

BS=business situs, which this Court has defined as the state in which "intangibles . . . are used in the business or are incidental to it, and have thus become 'integral parts of some local business.'" *First Bank Stock Corp. v. Minnesota*, 301 U.S. 234, 237 (1937).

BS/CD=the state allocates income to business situs or, if none, to commercial domicile.

n.a.=the state does not allocate that class of income.

*=the state does not subject corporations to a net income tax.

**=the state does not impose an income tax on dividends received by corporations. Conn. Gen. Stat. Ann. § 12-217(a) (West Supp. 1991); Ky. Rev. Stat. Ann. § 141.010(12)(b) (Michie/Bobbs-Merrill 1991); Pa. Stat. Ann. tit. 72, § 7401 (3)(1)(a), (b) (1990).

FOOTNOTES

[1] This chart includes state allocation rules for corporations generally, and not for special industries.

[2] In some states, a class of income may be either allocable or apportionable, depending on certain characteristics of the property or transaction and peculiarities of the state law. This chart shows the state to which income is assigned only when it is determined to be allocable in a state. Thus, for example, if a state allocates some dividends and apportions others, the chart would show the situs of the allocable dividends only.

[3] Gains and losses from the sale of partnership interests are allocable to the state in the ratio of the original cost of partnership tangible property in the state to the original cost of partnership tangible property everywhere, determined at the time of the sale. If more than 50 percent of the value of the partnership's assets consist of intangibles, gain or loss is allocated to the state in accordance with the sales factor of the partnership for its first full tax period immediately preceding the tax period of the partnership during which the partnership interest

was sold. Cal. Rev. and Tax. Code § 25125(d) (West 1992); Haw. Rev. Stat. §§ 235-26(d) (1992); Minn. Stat. Ann. § 290.17, subd. 2(c) (West Supp. 1992); Or. Rev. Stat. § 314.635(4) (1986 and Supp. 1990).

[4] Income received from intangible property held for investment (*i.e.*, interest and dividends) is allocated to the state if the situs of the corporation is in the state or if the intangible property was acquired as income from property held in the state or as a result of business done in the state. Ga. Code Ann. § 48-7-31(c)(1) (Supp. 1991). The "situs of the corporation" is its business situs. *Owens-Illinois Glass Co. v. Oxford*, 116 S.E.2d 293, 299 (Ga. 1960).

[5] All income is apportionable unless taxpayer proves (a) that the income is not part of a unitary business and (b) that the taxpayer has not claimed the income to be unitary in other states. In that case, the income is not taxed by Nebraska. Neb. Rev. Stat. § 77-2734.06(1) (1990).

[6] Certain dividends, interest, and capital gains (defined as "investment income") are apportioned on the basis of the payor's presence in the state. Other categories of dividends, interest, and capital gains are apportioned on the basis of the payee's factors in the state, while others are not taxed at all. N.Y. Tax Law §§ 208.9, 210 (McKinney 1986 and Supp. 1992).

[7] All interest, some dividends, and some capital gains from the sale of intangible propery, are apportioned on the basis of the payee's factors. Some dividends and gains from the disposition of certain dividend-yielding assets are apportioned on the basis of the payor's physical assets in the state. Ohio Rev. Code Ann. § 5733.051(E), (F), (H) (Anderson 1991).